

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-K
March 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

Q ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
For the fiscal year ended December 31, 2008

or

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

Commission file number 1-10367

Advanced Environmental Recycling Technologies, Inc.
(Exact name of Registrant as specified in its charter)

Delaware
(State of Incorporation)

71-0675758
(I.R.S. Employer
Identification No.)

914 N Jefferson Street
Post Office Box 1237
Springdale, Arkansas
(Address of principal executive offices)

72764
(Zip Code)

Registrant's telephone number, including area code:
(479) 756-7400

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:
Class A common stock, \$.01 par value

Name of Each Exchange on Which Registered:
NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting
company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing stock price of such common equity as of the last business day of the registrant's most recently completed second fiscal quarter was \$17,941,635 (for the purposes hereof, directors, executive officers and 10% or greater shareholders have been deemed affiliates).

Number of shares of common stock outstanding at March 25, 2009: Class A — 47,423,680; Class B — 1,465,530

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Definitive Proxy Statement for our 2009 Annual Meeting scheduled to be held May 28, 2009, and expected to be filed within 120 days of our fiscal year end, are incorporated by reference into Part III.

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Part I

Item 1. Business.

Summary

Advanced Environmental Recycling Technologies, Inc. (AERT), founded in 1988, recycles polyethylene plastic and develops, manufactures, and markets composite building materials that are used in place of traditional wood or plastic products for exterior applications in building and remodeling homes and for certain other industrial or commercial building purposes. Our products are made primarily from approximately equal amounts of waste wood fiber, which have been cleaned, sized and reprocessed, and recycled polyethylene plastics which have been cleaned, processed, and reformulated utilizing our patented and proprietary technologies. Our products have been extensively tested, and are sold by leading national companies such as the Weyerhaeuser Company (Weyerhaeuser), Lowe's Companies, Inc. (Lowe's) and Therma-Tru Corporation. Our products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as a low maintenance, exterior green (environmentally responsible) building alternative for decking, railing, and trim products.

Products

Using the same basic process and material, we manufacture the following product lines:

- Commercial and residential decking planks and accessories such as balusters and handrails (MoistureShield® and Weyerhaeuser ChoiceDek®),
- Exterior door components, and
- Exterior housing trim (MoistureShield®)

The wood fiber content of our products gives them many properties similar to all-wood products, but we believe the plastic content makes our products superior to either all-wood or all-plastic alternatives because:

- Unlike wood, our products do not require preservatives or treatment with toxic chemicals nor do they require yearly water sealing or staining.
- Our products are less subject to thermal contraction or expansion and have greater dimensional stability than competing all-plastic products.
- Our products are engineered for superior moisture-resistance and will not swell or expand like wood.
- Our products can be designed and extruded through dies to a desired shape in accordance with customer specifications, which helps the customer to minimize waste.
- Our products are less subject to rotting, cracking, warping, and splintering, insect infestation and water absorption than conventional wood materials.
- Our products can be aesthetically enhanced to provide a wood-like or grained surface appearance.
- Our products can be combined with coloring agents and/or other additives to provide various colors and aesthetics.

Our latest generation of products offers multidimensional color levels to more closely resemble the natural look of wood. Additionally, we have recently developed a deck board for markets requiring products with fire resistant properties. Also, we began to include a mildewcide in our products in 2006 that inhibits the growth of mold.

Based upon our extensive product testing and successful extended field history of over a decade, we offer a limited lifetime replacement warranty on our products against rot and fungal decay, and termite and insect damage.

Marketing and Sales

General Market Strategy. Our products are designed for applications where we can add the greatest value and address market needs, i.e. for external applications where wood is prone to rot and/or requires substantial yearly maintenance in the form of staining or water sealing. Though we believe there are many possible applications for our wood/plastic composite technology, we have focused our resources and personnel on outdoor decking and handrail components, door and exterior trim components, and outdoor fencing, which in our view represent the most attractive market opportunities at this time. Within our chosen markets, we are constantly working to develop and improve strong customer relationships.

Sales and Customer Service. We provide sales support and customer service through our own marketing department, contract marketing through outside commissioned representatives, through Weyerhaeuser, and through training programs for our customers and their sales associates. We also promote our decking products through interactive displays at national, regional, and local home and garden shows, as well as through in-store displays. Our in-house sales and customer support team is focused on serving commercial decking contractors and customers and supporting the sales professionals at our regional building products distributor customers as well as Weyerhaeuser and Lowe's. Information and customer service are provided through the websites www.choicedek.com and www.moistureshield.com, and through a national toll-free customer assistance telephone number: 1-800-951-5117.

Cyclical Nature of Building Products Industry. Our products are used primarily in home improvement and new home construction. The home improvement and housing construction industries are subject to significant fluctuations in activity and periodic downturns caused by general economic conditions. High fuel prices, reduced disposable income, and economic uncertainty in particular can lead to reduced home improvement activity, such as has occurred since mid-2006. Reductions in such activity has an adverse effect on the demand for our products. We have focused a large portion of our business on the remodel and repair market segment, which we believe is less cyclical than the new homebuilding market.

Facility Upgrades/Product Innovation. In our constant pursuit to satisfy our customers, and to keep up with changing trends in the marketplace, we routinely analyze the need to develop new products and improve existing products. We have invested significantly in plastic recycling technology and infrastructure over the last several years, which is also a strategic initiative designed to help insulate our raw materials purchasing from wide price swings associated with the petrochemical markets. As technology has improved so has the aesthetics of our products, which are overwhelmingly composed of recycled materials.

The composite decking business is continuously evolving. The technology used to manufacture wood/plastic boards has advanced significantly over the last four years and many contemporary products have much improved aesthetics. Going forward, it will be important for AERT to continue to innovate and keep in close touch with consumer trends and focus on regional market trends.

Innovation

We are committed to becoming the leader in green building products from recycled plastic materials. In addition, we believe plastic recycling technologies could lead to new opportunities in the future. Our Watts, Oklahoma facility, which is being designed to recover, utilize, and convert lower grades of waste plastics into usable feedstocks, is an example of our efforts to continually improve our recycling technology. By utilizing technology, we are upgrading the quality and aesthetics of our products made from primarily recycled raw materials to levels comparable to virgin resin based materials.

As manufacturing technology and aesthetics of composite decking improve, market trends are also shifting. Consumers are demanding more variety and selection compared to prior periods as demand for a wider selection of decking colors appears to be increasing. Also, the evolution toward a more natural wood look appears to be increasing

on the higher end of the market, while decreasing wood prices have widened the price differential on the lower end. Our MoistureShield® decking line has been upgraded and reintroduced to address these trends in the market. We will continue to work toward more selection combined with innovation and new products in conjunction with our customers.

Green Building Products

We have been recycling plastic and manufacturing green building products since our inception in 1988, and we intend to continue building our brands and differentiating AERT as a green building products company. Listed below are the major categories of products we manufacture and markets we supply.

ChoiceDek® Decking. We currently sell our ChoiceDek®-branded decking products in the home improvement warehouse (HIW) market through Weyerhaeuser to Lowe's. Sales to Weyerhaeuser comprised 78% of our total sales in 2008. This market segment primarily focuses on the "do-it-yourself" ("DIY") market in which homeowners buy, build, and install their own decks. The DIY market is also serviced by the Home Depot, as well as several smaller regional chains. Our decking products are not currently carried in Home Depot, and the ChoiceDek® brand is exclusive to Lowe's. ChoiceDek® has been sold in Lowe's exclusively from 2001 until 2007. Lowe's started carrying another, though higher priced, decking brand beginning in 2007, which could limit ChoiceDek's® growth. Lowe's is broadening the decking category and adding more accessories as it attempts to broaden its customer base and gain market share. ChoiceDek® is promoted through in-store displays and an ongoing print and marketing campaign that targets the residential decking market. We maintain a nationwide sales and customer service group. Lowe's also conducts national print and television ads for the products it carries.

In October 2008, we signed a supply agreement with Lowe's for distribution of ChoiceDek® brand decking materials and other products and accessories by direct sales to Lowe's. However, we will only begin selling pursuant to the new Lowe's agreement upon termination of the Weyerhaeuser agreement and sales arrangement, which termination is contingent upon our purchasing all existing saleable ChoiceDek® inventory from Weyerhaeuser and establishing an adequate line of credit to finance Lowe's inventory requirements. We agreed during the term of the new Lowe's agreement to distribute and sell ChoiceDek® brand decking and other ChoiceDek® products (and other products having the same or substantially the same formulation and design) only to Lowe's in the HIW market; however, this exclusive sale commitment excludes and does not restrict sales of our MoistureShield® decking materials and other non-ChoiceDek® products. Lowe's reserves the right to manufacture, distribute and sell products of the same type or class as the ChoiceDek® products and the parties may consult and agree from time to time to add or delete products to be subject to such exclusivity provisions. We agreed to provide customary support services in connection with the arrangement and to treat Lowe's as a "most favored customer" as it relates to the ChoiceDek® exclusive products. The initial term of the agreement is two years from January 1, 2009 with automatic one year renewals unless either party elects in advance not to renew, although the agreement may be terminated earlier by either party in the event of a default by the other party. In addition, if during the term of the new Lowe's agreement we propose to sell or transfer any material portion of the AERT business that provides Lowe's the ChoiceDek® products, Lowe's is entitled to a 60-day right of first refusal to acquire such business. Lowe's may terminate the Lowe's agreement if it does not exercise such right of first refusal.

MoistureShield® Decking. Our MoistureShield® brand line of decking products is currently sold to select primary distributors, who re-sell it to lumber dealers and contractor yards for sale to local deck builders and home builders. Most of our MoistureShield® customers are regularly purchasing, or have been exposed to, competing brands of composite decking. On this higher end segment, we believe success will require converting customers from competing products to our brands. The MoistureShield® decking line allows us to diversify our customer base.

Door Component Products. We sell our MoistureShield® industrial products to door manufacturers for use as component parts in products. For example, we manufacture door rails built into doors by Therma-Tru Corporation. In marketing these products, we emphasize the "value-added" feature of the MoistureShield® composite product, which unlike competing wood products, can be engineered to incorporate certain desired end-product characteristics that save our customers time and expense. Customers also avoid the need for chemical treatments to their final product, which are often otherwise necessary to prevent rot and sustain durability. The durability of our MoistureShield® composite components allows our customers to extend the lifetime or warranties of their products while reducing or eliminating warranty claims costs. We are unable to predict the future size of the markets for MoistureShield® industrial products; however, we believe that the national door and window and commercial and residential trim markets are large and will allow us to diversify our customer base over time as we add production capacity and focus on additional opportunities.

Exterior Trim and Fascia Products. We have marketed an exterior trim and fascia system under the trade names MoistureShield® Trim and MoistureShield® CornerLoc. Several national homebuilders have been specifying and

using the product. We believe this product line has significant growth potential as a green alternative to PVC and wood trims to be distributed and sold in conjunction with our MoistureShield® distributors.

International Sales. In 2007, we commenced exporting to a new distributor in the Peoples Republic of China and received the Award for Innovation at the Beijing Builder's Show in China. Shipments continued at a modest pace in 2008. We have also recently shipped a limited amount of product to other countries, and are seeking to increase our international shipments in 2009. Additionally, we plan to increase our green building and sustainability marketing focus in 2009.

Competition

Our products compete with high-grade western pine, cedar and other premium woods, aluminum, high-performance plastics, and an increasing number of composites and other construction materials. We believe that our products have superior characteristics, which make them a better value for the consumer; however, they are more expensive initially than traditional wood products. Manufacturers of some competing products, however, have long-established ties to the building and construction industry and have well-accepted products. Some of our competitors are larger and have research and development budgets, marketing staffs, and financial and other resources that surpass our resources.

Sales of non-wood decking products to date represent a small portion of the decking market. Pressure treated pine, cedar, redwood and other traditional woods constitute the vast majority of annual decking sales. We thus view wood decking as our principal competitor. The wood decking industry is highly segmented with many small to medium sized manufacturers. Wood decking is principally a commodity that competes as the low-priced product, whereas the more expensive non-wood products must compete on features and performance.

Among manufacturers of alternative decking materials, we view Trex Company, TimberTech Ltd., Tamko Building Products and Fiber Composites LLC as our primary competitors. The market for door products is highly segmented, with many competitors. We believe that our MoistureShield® industrial products have superior characteristics and are competitively priced. We emphasize durability, which means that manufacturers and homebuilders using our products should see reduced warranty callbacks and higher customer satisfaction. Our product competes not only on durability, but also the ability of the customer to order a product that is custom manufactured to its specifications.

Intellectual Property and Proprietary Technology

Our products are built for hostile, external environmental conditions. Our recycling processes focus on intensive cleaning and reformulating of our raw materials prior to extrusion. Our extrusion process is unique and focuses on total encapsulation of the wood fibers. Our composite manufacturing process and our development efforts in connection with waste plastics reclamation technologies involve patents and many trade secrets that we consider to be proprietary. We have also developed certain methods, processes, and equipment designs for which we have sought additional patent protection. We currently have 12 patents and six patents pending in the U.S. Our patents cover plastic recycling processes, methods, and apparatus or specially designed equipment as well as the composite product that we manufacture. The composite product patent was issued in 1998 and expires in 2015. This patent covers the unique properties, formulation and processing parameters of our encapsulated wood/polyethylene plastic composite building material.

We have five patents expiring in 2010 related to early stage plastic recycling processes and initial apparatus or equipment. We believe the plastic waste stream has diversified and has become more complex and difficult since that time. We have subsequently updated and continued to refine our recycling processes, procedures, and technologies since that time, many of which improvements are covered in later issued patents or pending patent applications. We have taken additional measures to protect our intellectual property and trade secrets by restricting access to our facilities and maintaining a policy of non-disclosure among our associates, which includes requiring confidentiality and nondisclosure agreements.

Raw Materials

Wood Fiber. The wood fiber we use is waste byproduct generated by hardwood furniture, pallet, cabinet, and flooring manufacturers. Until recently, the cost of acquiring the waste wood has primarily been the handling and transportation costs involved in getting the material to our facilities. Costs vary with transportation costs in general, which are related to petroleum prices and the supply and demand for over-the-road trucking services. Our cost of sourcing waste wood fiber has increased over the last three years due to increases in transportation costs, but remains a small proportion of our total costs. The housing slowdown starting in mid-2006 reduced the demand for hardwood building products and has caused some of our suppliers to temporarily close facilities, which has forced us to pay higher costs to source wood elsewhere. In addition, we now increasingly see competition for scrap wood fiber for use as a fuel to replace natural gas or oil burners for both residential and industrial applications.

Recycled Plastics. We use both post-industrial and post-consumer waste polyethylene. The largest portion of the plastic materials we use is mixed with paper and other non-plastic materials, which lessen its value to other plastic recyclers. By primarily sourcing these contaminated waste plastics prior to processing, we produce a usable but lower cost feedstock for our composite extrusion lines. We believe our investments in recycling technology and

infrastructure will create a significant raw material cost advantage compared to several of our virgin resin based competitors while offering a more competitive green building product. We also purchase plastic raw materials from outside sources, including virgin resin producers. These materials are more expensive and more sensitive to price swings related to the petrochemical industry. We also are subject to various quality and consistency problems when dealing with third party scrap suppliers, which increases our costs.

Our Watts, Oklahoma plastic recycling facility that is under construction is designed to allow us to use the less desirable, but low cost, forms of waste polyethylene, which should greatly assist us in regaining a competitive advantage and maintaining a low cost structure. The project involves retrofitting a large agriculture hog feedout and finishing facility and its confinement buildings into a state of the art plastic recycling and washing facility. The Watts facility is based on a successful joint development project involving polyethylene film recovery with the Dow Chemical Company earlier in our history. Once operational, we believe that further refinement of this technology could lead to additional revenue opportunities beyond composite decking and building materials. The initial phase of the Oklahoma project is expected to commence operations in the second quarter of 2009.

Competition for Raw Materials. As the wood/plastic composites industry grows, we sometimes compete for raw materials with other plastic recyclers or plastic resin producers. We believe that our ability to use more contaminated polyethylene limits the number of competitors. Nonetheless, we expect to continue to encounter new entrants into the plastics reclamation business. We increased our capacity for processing waste plastic in recent years, which reduced our dependence on outside suppliers and gave us more control over our costs, but our costs are still not to our desired levels.

Industry Standards

Local building codes often require that building materials meet strength and safety standards developed by building code organizations and that, in order to qualify, the materials be evaluated by an independent testing organization. Our decking, handrails and stair applications are covered in a National Evaluation Report (NER), which provides local building inspectors and code officials with independent testing and installation information regarding our products. We believe that the NER listing has helped to increase sales and market acceptance of our decking products. In addition to upgrading our product offering, we have submitted to the International Code Council for building products our building code approval package, which is pending final review. We expect to receive a new code report in the near future.

Employees

During 2008, we reduced our workforce by approximately 150 associates as we restructured our operations to improve efficiencies and lower costs. At December 31, 2008, we employed 514 full-time associates; 6 at our Texas facility, 436 manufacturing personnel in Arkansas and 72 making up our office, executive and sales team.

Available Information

We make available free of charge on our website (www.aert.com) our periodic reports filed with the SEC on Forms 10-K, 10-Q, and 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

Item 2. Properties.

We have downsized operations, subleased facilities, idled excess manufacturing capacity, and reduced headcount as a result of the economic downturn in the U.S. We currently manufacture all of our composite products at an extrusion facility (Springdale North) in Springdale, Arkansas. Springdale North contains four extrusion lines and contained a plastic recycling facility during most of 2008. The plastic recycling operation at our Springdale North facility was consolidated with our Lowell, Arkansas plastic recycling facility in late 2008. The Springdale North plant consists of a 103,000 square foot facility located on ten-acres in the Springdale industrial district. We own a second composite extrusion facility (Springdale South) in Springdale that has been temporarily idled since July 2008 due to the current recession and downturn in building activity. Operations at the facility will resume when demand for our products increases. Springdale South contains one extrusion line, consists of 60,000 square feet and is located on 16

acres in the Springdale industrial district. Additionally, we finalized the closure of our Tontitown, Arkansas paint operation.

Until the fourth quarter of 2007, our Junction, Texas composites manufacturing facility produced primarily Weyerhaeuser ChoiceDek® products; however, we suspended extrusion operations at the facility in October 2007. We determined at the end of 2008 that we would not resume operations at the facility, and accordingly have recorded an impairment charge for fixed assets at our Junction facility of \$3.9 million. The Junction plant consists of a 49,000 square foot manufacturing and storage facility on a seven acre site.

We operate a 45,000 square foot facility in Lowell, Arkansas that is used for plastic recycling, blending, and storage. We lease four warehouses totaling 475,000 square feet and a ten acre tract that are also in Lowell. Two of these warehouses have been subleased as we reduced the quantity of inventory on hand. The ten acres of land in Lowell are used for storage and load-out of finished goods.

We lease an office, storage building, and parking lot adjacent to the Springdale North facility. The lease is renewable yearly. The office and storage facility is comprised of 10,000 square feet on 2.36 acres and houses our corporate offices.

In December 2007, we entered into a related party lease for the use of 60 acres in Watts, Oklahoma where we commenced construction of an additional plastics recycling facility in September 2008. This facility is projected to commence operations in the second quarter of 2009, and is intended to recycle lower grades of polyethylene plastic scrap in order to reduce our costs of recycled plastics and value added compounds and to allow for potential sales of recycled plastics to third parties.

Item 3. Legal Proceedings.

Class Action Lawsuits

On February 26, 2008, plaintiffs filed a purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek® composite decking for damages allegedly caused by mold and mildew stains on their decks (*Pelletz v. Weyerhaeuser Company, Advanced Environmental Recycling Technologies, Inc. and Lowe's Companies, Inc.* pending in U.S. District Court, Western District of Washington (Seattle Division)). The plaintiffs originally sued AERT, Weyerhaeuser Company, and Lowe's Companies, Inc., asserting causes of action for alleged violations of the Washington Consumer Protection Act and other state consumer protection acts, breach of implied warranty of merchantability, breach of express warranty, and violations of the Magnuson-Moss Warranty Act.

On March 10, 2008, unrelated plaintiffs filed a similar purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek® composite decking for damages allegedly caused by mold and mildew stains on their decks. (*Joseph Jamruk et al v. Advanced Environmental Recycling Technologies, Inc. and Weyerhaeuser Company* in U.S. District Court, Western District of Washington (Seattle Division)). The plaintiffs sued AERT and Weyerhaeuser Company, asserting causes of action for actionable misrepresentation, alleged violations of the Washington Consumer Protection Act, unjust enrichment, and breach of express warranty. On May 19, 2008, the plaintiffs in both cases filed a consolidated complaint against AERT and Weyerhaeuser Company.

On August 21, 2008, the parties filed with the court a class action settlement agreement for preliminary approval. The settlement includes decking material purchased from January 1, 2004 through December 31, 2007, along with decking material purchased after December 31, 2007 which was manufactured before October 1, 2006 when a mold inhibitor was included in the manufacturing process. The court approved the class action settlement on January 9, 2009.

As part of the settlement, we and the other defendants have agreed not to use the terms "minimum maintenance," "low maintenance," "easy to maintain," or "virtually maintenance free" in ChoiceDek® marketing materials. AERT will also provide additional cleaning instructions on the ChoiceDek® website to assist customers with cleaning their decks. AERT will provide national notice of the settlement to putative class members and establish a call center to answer customer questions regarding ChoiceDek®. AERT will also self-administer a claim resolution process whereby eligible deck owners may file a claim for significant mold spotting within six months of when the settlement becomes final and unappealable. If eligible, deck owners who followed installation instructions and timely file a claim for significant mold spotting may receive relief such as deck cleanings and applications of a mold inhibitor, gift cards for use at Lowe's, replacement materials, and/or refunds under certain criteria. An arbitration provision is included in the settlement agreement, which provides for disputes arising from the claim resolution process.

AERT has accrued expenses of \$4.7 million associated with the settlement of the class action lawsuit. The estimate includes \$2.9 million for the claims resolution process and \$1.8 million for plaintiffs' attorney fees to be paid over 2009 and 2010. The claim resolution process will have an annual cost limitation to AERT of \$2.8 million in 2009, \$2.8 million in 2010, and if necessary, \$2.0 million per year thereafter until the claim resolution process is completed.

Advanced Environmental Recycling Technologies, Inc. v. American International Specialty Lines Insurance Company

On April 18, 2008, AERT filed suit against its umbrella liability insurer, American International Specialty Lines Insurance Company ("AISLIC"), to obtain a defense against the then-pending class action lawsuits (discussed above) (the "Jamruk/Pelletz Lawsuits") under one or more umbrella liability insurance policies issued by AISLIC and to recover AERT's past defense costs, interest, and other damages and attorneys' fees relating to AISLIC's denial of coverage for the Jamruk/Pelletz Lawsuits. After the settlement of the Jamruk/Pelletz Lawsuits was approved in January 2009, AERT amended its claims against AISLIC to also seek recovery for amounts to be paid by AERT in connection with the settlement. AERT's claims against AISLIC are currently pending in the United States District Court for the Northern District of Texas, Dallas Division.

Energy Unlimited, Inc. vs. AERT, Inc.

This case originally started as a suit on account by Energy Unlimited, Inc. against AERT to collect the balance it asserts to be owed on work performed on the Springdale South facility material handling and drying systems. The claim was in the original amount of \$0.2 million. AERT contends that the design and installation by Energy Unlimited, Inc. was faulty resulting in a series of explosions and the subsequent need to undertake refabrication of the material handling and drying systems. AERT has filed a counter claim for its out of pocket loss relating to an explosion occurring on April 2, 2007 and for the cost to fix and complete the material handling and drying systems properly in the amount of \$1.2 million. This matter is in the early phase of discovery. AERT intends to vigorously defend the initial claim and pursue its counter claim based on the faulty design, improper installation, and serious safety defects of the material handling and drying systems by Energy Unlimited, Inc.

Other Matters

AERT may be involved from time to time in other litigation arising from the normal course of business. In management's opinion, this litigation is not expected to materially impact the Company's results of operations or financial condition.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2008.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our Class A common stock is traded on the NASDAQ Capital Market under the symbol AERT. As of March 25, 2009, there were approximately 1,500 holders of record of Class A common stock and 11 holders of record of Class B common stock. The closing price of our common stock was \$0.17 on December 31, 2008. We have not previously paid cash dividends on our common stock and there are currently restrictions under various debt obligations and our Series D preferred stock des